



State Street Corporation

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Mr. Christopher Kirkpatrick
Secretary
U.S. Commodity Futures Trading Commission
1155 21st Street, NW
Washington, DC 20581

Via email: projectkiss@cftc.gov

Re: Commodity Futures Trading Commission Request for Public Input on Simplifying CFTC Rules (Project KISS)

Dear Mr. Kirkpatrick:

State Street Corporation (“State Street”) appreciates the opportunity to comment on the request for information from the Commodity Futures Trading Commission (“CFTC” or “Commission”) on how the CFTC’s existing rules, regulations, or practices could be applied in a simpler, less burdensome and less costly manner as part of the Project KISS initiative.

Headquartered in Boston, Massachusetts, State Street specializes in providing institutional investors with investment servicing, investment management, data and analytics, and investment research and trading. With \$31.037 trillion in assets under custody and administration and \$2.606 trillion in assets under management as of June 30, 2017, State Street operates in more than 100 geographic markets worldwide. State Street’s primary banking subsidiary (State Street Bank and Trust Company) is provisionally registered with the CFTC as a swap dealer and is a major global dealer in foreign exchange (“FX”), operating through multiple branches in U.S. and foreign markets.

State Street strongly supports the CFTC’s goal to simplify and modernize existing rules, regulations, and practices. While cross-border guidance may extend beyond Project KISS, we encourage efforts to reduce market fragmentation and resulting adverse effects on liquidity. Our targeted recommendations in this letter focus on cross-border guidance, business conduct standards, and swap execution facility (“SEF”) trading and registration.

Cross-border: State Street’s recommendations for more useful substituted compliance determinations

Substituted compliance findings are essential to the ability of U.S. firms to conduct business overseas efficiently. Determinations should take a holistic view of non-U.S. jurisdictions’ swaps regulations and not focus on a rule by rule analysis. The principles-based, outcomes-based analysis should determine if, as a whole, the non-U.S. regulations accomplish the goals of the

Dodd-Frank Act. For example, the CFTC decided that the European Market Infrastructure Regulation (“EMIR”) valuation/dispute resolution and portfolio reconciliation rules are comparable to the U.S. rules and permit swap dealers to follow the EMIR rules for those components when a client is subject to EMIR. However, there are additional swap documentation requirements for which EMIR is not considered comparable and U.S. firms like State Street must follow the U.S. rules. Each time we take advantage of the EU substituted compliance determination, satisfying the U.S. rule is a piecemeal effort of combining EMIR provisions with Dodd-Frank Act provisions in our documentation, which increases rather than reduces, the compliance burden on swap dealers.

Recommendation: State Street recommends that the CFTC engage with non-U.S. peer regulators, and reach more useful substituted compliance determinations, taking a holistic view of non-U.S. jurisdictions’ swaps regulations rather than focusing on a rule by rule analysis.

Business conduct standards: State Street’s recommendations to improve the effectiveness of disclosure requirements for FX dealers

The CFTC’s business conduct standards for swap dealers include several provisions which are costly and time-consuming without yielding significant benefits to clients in respect of FX swap activity. The FX market is highly liquid and standards such as the mid-market price are readily observable in the marketplace, particularly in more liquid currencies, and sophisticated investment managers actively work with multiple dealers to identify competitive pricing in the FX markets.

U.S. swap dealers have implemented the CFTC’s business conduct standards and other regulatory reporting requirements following the Dodd-Frank Act. Aspects of these standards and requirements have yielded benefits for investors. For example, State Street’s FX business provides pre-trade disclosures to clients in compliance with the business conduct rules, such as the material economic terms and conflicts of interest. We appreciate and agree with the goal of pre-trade transparency; however, there are three key areas of the business conduct rules for which we see opportunities for improvement and simplification.

First, the pre-trade mid-market mark requirement is not demanded or utilized by clients. The CFTC granted relief for 31 currencies; however, this creates operational challenges in tracking to which currencies the requirement applies and which clients have consented to this no-action relief. In addition, verbally providing the pre-trade mid-market mark does not satisfy the requirement and dealers are required to follow up with clients in writing. By this time, the client or its manager would have made the decision to execute the transaction, the client would receive the daily mark going forward, and the follow up does not serve a meaningful purpose to investors. In contrast, and while not a pre-trade value, the requirement to provide a daily mark provides clients of U.S. dealers with a transparent appraisal of the mid-market mark, which may assist clients in calculating valuations for their own risk management purposes during the life of the swap. Overall, this pre-trade requirement is contrary to the KISS initiative to make regulation efficient, effective, and appropriately tailored.

Recommendation: State Street recommends eliminating the pre-trade mid-market mark requirement, or providing relief that permits the pre-trade mid-market mark to be provided upon request for all currencies.

Second, the business conduct standards include the requirement to notify counterparties that they can request and consult on the design of a scenario analysis. The CFTC describes the analysis as “an expression of potential losses to the fair value of the swap in market conditions ranging from normal to severe in terms of stress.” Our business has readily incorporated the notification to clients within our policies and procedures and has also dedicated significant resources since the compliance date on the software and systems required to construct such a scenario analysis. However, since the compliance date, we have not received a single request for a scenario analysis from clients. We note that if clients request such analysis, regardless of any requirements to do so, we would work with them to build a scenario analysis to assist their decision to begin or increase their trading with us. However, scenario analyses add limited value for FX instruments such as swaps, forwards, non-deliverable forwards (“NDFs”), and plain vanilla options. Thus, we note that being mandated to prepare for something that our clients have not requested is diverting resources away from areas where it could be better spent, such as building new automated solutions to enhance our trade monitoring.

Recommendation: State Street recommends eliminating the scenario analysis requirement. As an alternative, State Street recommends modifying the requirement to be less prescriptive overall and to recognize that scenario analyses add limited value for FX instruments such as swaps, forwards, NDFs, and plain vanilla options.

Third, the swap documentation rules require that a swap dealer provide a pre-trade draft acknowledgment to clients upon request. Despite executing millions of trades, we have not received any requests for a pre-trade draft acknowledgement. Investors and dealers alike typically rely on other pre-trade market transparency measures to determine whether to execute a trade, rather than a draft acknowledgement. Including a draft acknowledgement in the negotiation process imposes a time lag between pricing and execution, and therefore increases risk to the counterparties. It may cause the bid/ask spread to broaden, or may prevent execution when the market is favorable. In addition, any decision to execute a swap is ratified using the well-established confirmation process, which has been utilized by the market well in advance of introduction of the specific Dodd-Frank Act regulations, as well as the reconciliation process. As with the pre-trade mid-market mark and scenario analysis, this requirement imposes preparatory costs on swap dealers without any ancillary benefit to investors in the FX market.

Recommendation: State Street recommends that the CFTC eliminate the pre-trade draft acknowledgement related to swap documentation. As an alternative, State Street recommends eliminating the pre-trade draft acknowledgement related to FX, as it is not useful given the time delay it may cause to trade execution.

SEF trading and registration: State Street’s recommendations to restore U.S. investor access to global NDF markets

The CFTC’s SEF registration requirements and the nearly automatic linkage between designation for mandatory clearing and a subsequent “made available for trading” determination resulting in mandatory SEF trading distorts U.S. participation in global FX markets, particularly for NDFs, which are, unlike other types of FX transactions, considered swaps for purposes of the Dodd-Frank Act.

These flaws in the CFTC SEF-related rules extend beyond swaps currently designated for central clearing and SEF trading (under the CFTC rules, “required transactions”) and negatively impact swaps such as NDFs that are not designated for central clearing or SEF trading (“permitted transactions”). CFTC rules implementing the Dodd-Frank Act have fragmented

global FX markets, particularly for NDFs, creating competitive disadvantage for U.S.-based FX dealers and increasing costs for U.S. investors denied access to large, global pools of NDF liquidity.

U.S. investors seeking exposure to non-U.S. securities convert between relevant currencies using the services of a FX dealer. FX transactions may be for immediate (*i.e.* “spot”) or future (*i.e.* “forward”) access to currency. These transactions are typically physically settled, involving actual exchange of currency, but can also, for certain currencies, be net settled in cash without physical exchange of currency (*i.e.* “NDF”).

FX spot and forward trades are exempt from treatment as swaps, under U.S. rules, for most purposes of the Dodd-Frank Act. FX NDFs (and options), however, are considered swaps and are fully regulated by the U.S. CFTC.

The Dodd-Frank Act included provisions requiring the CFTC to move some swap counterparty exposure and trading away from traditional bilateral arrangements with swap dealers, and towards central clearing and trading on CFTC regulated SEFs. For some types of swaps, central clearing and SEF trading are now mandatory. FX NDFs have not been designated by the CFTC for central clearing or SEF trading, and should, in theory, be permitted to trade either bilaterally by voice or on electronic trading platforms, at the discretion of the counterparties. However, the CFTC’s SEF registration rules severely limit the ability of counterparties to trade NDFs over the platform of their choice, despite the lack of a SEF trading mandate. The CFTC decided that all U.S. multi-dealer swap trading platforms must register as SEFs, regardless of whether or not the instrument traded has been mandated for SEF trading, which subjects these multi-dealer trading platforms to highly prescriptive regulation by the U.S. CFTC.

In addition, the CFTC decided non-U.S. trading platforms accepting any trades from U.S. persons must follow the U.S. SEF registration rules. Non-U.S. trading platforms, already subject to their own local regulatory regime, are typically unwilling to subject themselves to extraterritorial regulation by a U.S. regulatory agency and refuse to accept trades from U.S. persons, including the branches of U.S. swap dealers in order to avoid SEF registration. Non-U.S. trading platforms should not be captured within the CFTC’s SEF registration rules when U.S. FX dealers and counterparties engaged in these types of swaps activities are already subject to Dodd-Frank Act requirements. The very prescriptive trading requirements and rules designed around the U.S. market are more important to ensuring safety and soundness than extraterritorial regulation of non-U.S. platforms. As a result of the current market fragmentation caused by extraterritorial regulatory implications, U.S. FX dealers and their U.S. clients are denied access to large portions of the global NDF market, resulting in higher costs for U.S. investors and competitive disadvantage for U.S. firms.

Additionally, confusion over Footnote 88 to the preamble of the Commission’s rules on SEFs has resulted in market fragmentation and liquidity concerns. Footnote 88 states that “a facility would be required to register as a SEF if it operates in a manner that meets the SEF definition even though it only executes or trades swaps that are not subject to the trade execution mandate.”¹ The footnote language indicates that SEF rules would apply to any transaction the SEF offered, whether or not mandated to trade on a SEF. As a result, availability of trading platforms for NDFs has been significantly limited, particularly overseas, despite the lack of a

¹ Core Principles and Other Requirements for Swap Execution Facilities; Final Rule, 78 Fed. Reg. 33476 (June 4, 2013), available at <https://www.gpo.gov/fdsys/pkg/FR-2013-06-04/pdf/2013-12242.pdf>.

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SEF mandate. Overall, confusion over Footnote 88 and the definition of a U.S. person, including a branch of a U.S. swap dealer, have created significant market fragmentation.

Recommendations:

- State Street recommends issuing guidance for non-U.S. SEFs that permits non-U.S. branches of U.S. banks to trade NDFs on such platform without triggering U.S. SEF registration.
- State Street also recommends eliminating Footnote 88.

Conclusion

State Street appreciates the opportunity to comment on the CFTC's request for information on how the Commission's existing rules, regulations, or practices could be applied in a simpler, less burdensome and less costly manner as part of the Project KISS initiative. We believe the adoption of our recommendations related to cross-border guidance, business conduct standards, and SEF trading and registration will help support the CFTC's goal to simplify and modernize existing rules, regulations, and practices.

Please feel free to contact me at smgavell@statestreet.com should you wish to discuss State Street's submission in further detail.

Sincerely,



Stefan M. Gavell